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September 5, 2000

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Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW
Room TWB-204
Washington, D.C. 20554

Re: Ex Parte Presentation in CC Docket No. 96-98

Dear Ms. Salas:

Please include the attached document, filed on behalf of the Promoting Active Competition Everywhere ("PACE") Coalition, in the record of the above-captioned proceeding. This document is an article from the September 4, 2000 issue of Barron's that discusses the practice of telecommunications equipment manufacturers financing sales of equipment to their customers.

In accordance with Section 1.1206 of the Commission's rules, an original and one copy of this letter is being filed with your office.

Sincerely,

Genevieve Morelli

Genevieve Morelli

cc: Dorothy Attwood
Jake Jennings
Jonathan Reel
Kathy Farroba
Ben Childers
Christopher Libertelli

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Loan Moans

Lucent and its rivals may soon regret their entry into the lending business

BY JACQUELINE DOHERTY • This past June, junk-bond investors began receiving some unusual calls. Lucent Technologies was trying to sell some of the loans it had extended to Winstar Communications as part of a $2 billion financing package that helped Winstar buy Lucent products. What was unusual, say investors familiar with the situation, was that Lucent the loans at less than 90 cents on the dollar.

When word got out that Winstar's paper was being offered at a discount, the company's junk bonds began to sink. Pat Dyson, a bond analyst at RBC Dominion Securities, recalls that Winstar's 12¾% junk bonds due in 2010 fell four points to 93, which pushed their yield to 14.2% from 13.3%, thus increasing the cost of any financing Winstar might do in the future.

The sale never occurred, however. Word was, says Dyson, that Winstar officials called Lucent and requested the debt sale be halted. Lucent, it seems, had never received Winstar's consent to sell the paper, as was required under the loan agreement. Lucent and Winstar both declined comment last week.

But that's not the end of the story — far from it. Instead of recovering, Winstar's junk bonds slid further to a price of 85, driving their yield up to 15.7%. The market fears Winstar debt will flood the market if Lucent continues to try to sell the loans and if Winstar issues more debt, as it has filed a shelf registration to do. It didn't help that a number of companies in Winstar's end of the telecommunications industry came out with disappointing second-quarter results. Taken together, these events have put Winstar under a cloud.

The attempted loan sale also begs the question as to what Lucent's $1.85 billion portfolio of loans and loan guarantees to its clients is really worth. And that, in turn, leads one to wonder whether the manufacturer of telecommunications equipment, with $38 billion in annual revenues, might someday have to take a writeoff on some portion of its loans and commitments to make loans, which now total $8.7 billion.

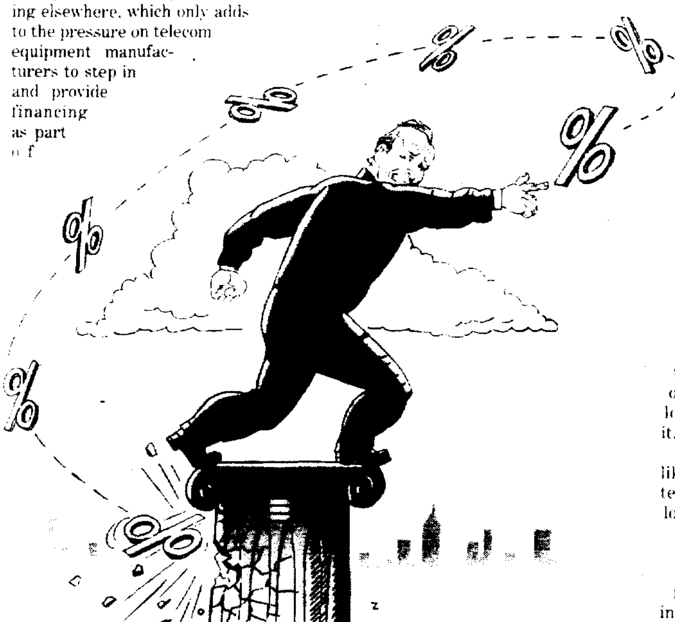
Lucent's shares, of course, have already been beaten down, from 82 in December to a recent 42, after a series of earnings disappointments. But don't be surprised if rising concern about loans to clients — already a sore point with investors — punishes the stock further.

Lucent is not alone in financing its clients' purchases. Traditionally, big equipment makers, like Lucent, **Nortel Networks**, **Ericsson** and **Nokia**, have helped arrange bank financing for customers. Only if no lender is found does the vendor consider extending its own credit. And even then, the manufacturer usually tries to resell the loan to a commercial bank as soon as possible.

Right now, with upstart telecom service providers racing to build their networks, competition to make equipment sales is increasingly fierce. Indeed, there is talk in the industry that some suppliers are offering unusually cheap financing to drive sales.

Some of the buyers, meanwhile, are having trouble finding affordable financing elsewhere, which only adds to the pressure on telecom equipment manufacturers to step in and provide financing as part of any equipment sale. As the table on this page shows, five of the top equipment suppliers currently have a total of $6.1 billion outstanding in client loans and loan guarantees. And that does not include the loans they've committed to making in the future — a number most won't disclose.

Nokia, for example, has $890 million in customer loans and guarantees outstanding at the end of June, a 48% increase over the past six months. Nokia officials note that the loans have grown in line with the expansion of their business.



GROWING PAINS

►*As financing for customers becomes an increasingly important part of the telecom equipment business, the risk to equipment manufacturers is rising. The table below shows financing has grown over the six months through June. Cisco provided us with more up-to-date information and at Ericsson, only full-year '99 data were available.*

	OUTSTANDING LOANS AND/OR GUARANTEES			
Company	(billions)	As of	(billions)	As of
Cisco Systems	$0.50	July 31, 2000	$0.25	Dec. 31, 1999
Ericsson	1.66	Dec. 31, 1999	1.17	Dec. 31, 1998
Lucent Technologies	1.85	June 30, 2000	1.75	Dec. 31, 1999
Nokia	0.89	June 30, 2000	0.60	Dec. 31, 1999
Nortel Networks	1.20	June 30, 2000	1.10	Dec. 31, 1999

*Figures do not include commitments for loans/guarantees that have not been drawn

Source: Company reports, comments

Nortel, for its part, has $1.2 billion of loans and $2.5 billion of financing commitments. Other big equipment makers, including **Alcatel**, are known to provide vendor financing for clients but decline to break out the amount of customer loans they hold.

The situation is likely to get worse. The construction of third-generation wireless systems around the world will require about $100 billion in spending just for equipment over the next five years, estimates Per Lindberg, a technology analyst at Dresdner Kleinwort Benson. He figures equipment manufacturers could be asked to pony up something like $15 billion of financing to get equipment sales, in part because the buyers are already stretched from spending billions on 3G licenses.

Whether any of the current loans will come back and bite the vendors is anybody's guess. Likewise, it's an open question as to where the financing for the next big round of telecom buildouts is going to come from if it doesn't come from the equipment makers. The financial markets are already choking on telecom paper, as the response to Lucent's Winstar overture indicates. And if financing dries up or becomes prohibitively expensive, that could hammer the shares of both the equipment manufacturers and the service providers.

One thing is certain. Equipment manufacturers don't want to become banks. "Issuers like Lucent and Nortel are saying, 'We have a lot of risk out on our balance sheets with these loans, and we're looking to get rid of it,' " says Dyson.

That means many of these firms, like Lucent, are looking for help. Potential alternatives include selling the loans directly to junk-bond investors or selling batches of loans into the asset-backed market. "We're continually working with the investment banks to find more and more investors," explains William Kerr, Nortel's senior vice president for corporate business development. The company wants to help customers obtain financing, without becoming a long-term investor itself. "If you're going to be successful you have to have a pipeline [of loans] that continues to flush out."

Nortel's chief financial officer, Frank Dunn, is quick to add that the company's sales are growing faster than its financings for customers. Says he, "I'm financing less now as a percentage of my business than I did last year." ►

Illustrations: this page and on cover Martin Kozlowski for Barron's

The folks at Ericsson may sell off some of their loans to clients, but banks will remain the primary source of funding, says Sven Ake Hellgren, Ericsson's vice president for corporate customer finance. **Cisco Systems**, another big user of loans to clients, is considering working with a finance company to establish a special-purpose corporation into which vendor loans could be sold, says Michael Hampton, general manager of Cisco Systems Capital.

"In some cases, the vendors may already have some exposure to a company that needs capital," says Bob Konefal, of Moody's Investors Service. "So it's in the vendors' interest to keep their customers alive."

The desire for alternative financing sources has grown in part because the equity and the junk bond markets, which have historically funded the building of telecom projects, have gotten finicky over the past six months or so. Funding has gotten especially tough for competitive local exchange carriers, or CLECs, which is what Winstar is. These startup companies spend heaps of money on equipment to build new telephone and datacom systems. But investors have gotten skittish because of some disappointing results and one bankruptcy in the sector. Even Winstar, one of the more established CLECs, has watched its stock fall to a recent 26 from a high of 66.50 in March.

"The capital markets have shut off, so there is more pressure to look for alternative sources of capital," says Bob Konefal, head of the telecom, media and technology groups at Moody's Investors Service. "In some cases, the equipment manufacturer may already have some exposure to a company that needs capital, so it's in the manufacturer's interest to keep their customers alive."

And, as the numbers grow, so does the risk of losing money on a loan. Consider that **GST Telecommunications**, a CLEC, filed for bankruptcy protection in May. **Siemens** had provided about $12 million of secured financing to the company, according to news reports. Or recall the disastrous bankruptcy of Iridium, to which **Motorola**, one of their major investors and service providers, had extended financing.

It should be noted that most of these loans use the telecom equipment as collateral, which makes them somewhat safer than typical unsecured junk bonds. And investment bankers can smell opportunity, especially where new types of financing structures often boast high fees.

Most bankers seem to be considering a financing structure that looks like a collateralized loan obligation, where a bunch of loans to a diverse group of industries have been pooled together and sold off. It's a technique that allows banks to continue to reap the fees from making loans but to then get those loans off their balance sheets quickly by selling them off to investors. This gives the banks the ability to make more loans.

Setting up this kind of arrangement in the telecom sector would provide a challenge, however, because the loans are large and by definition are all in one industry. So a pool of telecom loans wouldn't offer the diversification rating agencies normally require.

"We're trying to provide another way to finance the explosive growth of telecom," says Dansby White, head of structured finance origination in the Americas for Merrill Lynch. White is looking at ways to securitize vendor loans or leases from high tech, telecom and software companies. In fact, Lucent has already done one securitization of loans to clients, back in 1998. And Alcatel did one last year. Both were arranged through Citibank, which has a few more deals in the works, according to Radford West, a managing director in securitization at the bank.

So far, investors in the junk-bond market are treading cautiously. "We're just getting started" in evaluating loans to telecom customers, says Jerry Paul, portfolio manager of the Invesco High Yield Fund. He needs to figure out just how liquid the loans will be and what type of prepayment risk they entail; and determine their seniority and the documentation used for each loan. So far, the client loans seem to offer higher yields than bank loans, which Paul has purchased in the past. Still, he remains cautious. "It's too early to know if it's going to be a big deal," says Paul, "but it's worth some research." ■